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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1938

No. 312

JOHN M. TAYLOR, OSCAR A. KENNEDY AND H. RUSSELL HASTINGS, AS THE INDEPENDENT COMMITTEE FOR THE PROTECTION OF THE HOLDERS OF PREFERRED STOCK OF DEEP ROCK OIL CORPORATION,

Petitioners,

vs.

STANDARD GAS AND ELECTRIC COMPANY, REORGANIZATION COMMITTEE OF DEEP ROCK OIL CORPORATION, H. N. GREIS, TRUSTEE OF DEEP ROCK OIL CORPORATION, AND DEEP ROCK OIL CORPORATION.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT AND BRIEF IN SUPPORT THEREOF.

JASON L. HONIGMAN,
Counsel for Petitioners.

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PETITION FOR CERTIORARI.

NOTE.—References to the Record are shown as to Volume, by Roman numerals, and as to page, by Arabic numbers, i. e. (II-300), is Volume Two, page 300.

To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Your petitioners, John M. Taylor, Oscar A. Kennedy, and H. Russell Hastings, as the Independent Committee for the

Protection of the Holders of Preferred Stock of Deep Rock Oil Corporation, by their counsel, Jason L. Honigman, allege:

A. Statement of the Matter Involved.

1. Orders Appealed From.

The instant petition seeks to review certain orders in 77-B Bankruptcy proceedings for the reorganization of Deep Rock Oil Corporation, a Delaware Corporation (hereinafter referred to as "Deep Rock" or "Debtor"). By these orders, the District Court for the Northern District of Oklahoma compromised and allowed in the amount of five million dollars an alleged claim of Standard Gas and Electric Company (hereinafter referred to as "Standard") against Deep Rock, its subsidiary, and as part of the compromise of this claim, confirmed a Plan of Reorganization for said Debtor (I-363, 393). By these orders, Standard secured the major portion of the equity in the Debtor's assets at the expense of a five million dollar class of public preferred shareholders of the Debtor, who were thereby practically eliminated.

From these orders, Petitioners, a committee of preferred shareholders of the Debtor, appealed to the United States Circuit Court of Appeals for the Tenth Circuit (I-1-15, 436-64), which affirmed said orders by a divided Court (I-477-505). Circuit Judges Phillips and Williams each wrote an opinion for affirmance and Circuit Judge Bratton wrote a dissenting opinion. The primary issues before the District Court and the Circuit Court of Appeals revolved about the validity of the Standard claim, the propriety of its compromise, and the unfairness of the allocation of the Debtor's assets under the Plan of Reorganization.

2. Debtor's Business and Capital Structure.

The Debtor went into Federal Equity Receivership on March 2, 1933 (I-23), which proceedings were transferred

into 77-B proceedings in June, 1934 (I-25). Deep Rock was organized in 1919 by Standard and its affiliated interests through the purchase of a going oil business (II-629, 635-43). Its original name, Shaffer Oil and Refining Company, was subsequently changed to its present name (II-629, 631).

The Debtor is engaged as an integrated unit in the oil industry, producing, refining and selling gasoline, oil and other petroleum products (I-364, II-735). Its principal place of business is Tulsa, Oklahoma (I-36). It owns and operates 488 producing oil wells, 44 gas wells and a large refining plant (II-735). It owns or controls oil leases covering over 118,000 acres of oil lands located principally in Oklahoma, Kansas, Texas and Arkansas (II-735). It has its own pipe line gathering system totaling over 400 miles, and owns and operates approximately 600 tank cars (II-735-6). In addition, it distributes and sells its gasoline and other oil products through approximately 700 filling stations throughout the Midwest and Southwest territory (II-21, 736).

The capital structure of the Debtor consists of:

(1) *Notes.*—This is an issue of Ten Million Dollar Six Per Cent Notes of Deep Rock which matured March 1, 1933, and upon which no interest has been paid since that date (II-722-3). Practically all of the notes were sold to the public and except for a few large holders are widely spread among over four thousand small holders throughout the country (I-328-9, II-11, 420).

(2) *Preferred Stock.*—The preferred stock of the Debtor consists of fifty thousand shares of non-par stock which is entitled on liquidation to $100.00 per share and accumulated dividends of $7.00 per share per annum, unpaid since 1931 (II-114, 613, 631, 722-3, 821). Thus, as of the time of confirmation of the Plan of Reorganization, the total right

of participation of the preferred shareholders in the assets of the Debtor was approximately seven million dollars. All of the preferred shares with but few exceptions were sold to the public and are held among over fifteen hundred widely scattered shareholders (II-114).

(3) *Standard's Common Stock and Claim.*—Standard is the owner of practically all of the common stock of the Debtor (I-260, II-688-9). It also asserts a claim as a creditor of Deep Rock in the amount of approximately $9,300,000 on the balance of an open account between itself and the Debtor (I-23).

3. Standard Claim.

a. *Hearing On Contest of Claim.*

From the inception of the Debtor's receivership, the Standard claim as a creditor has been under attack as invalid in its entirety. Standard filed its claim in the equity receivership and renewed it in the 77-B proceedings (I-23, II-245, 266-276). The Receivers and the Trustee in Bankruptcy filed objections to the allowance of this claim (II-276-290, I-108-137). These objections were based primarily on the ground that the claim includes fraudulent charges by Standard against Deep Rock which should be eliminated from the open account and which, if eliminated, would leave no balance owing to Standard (II-283-288, I-108-132). The objection was further made that by reason of the complete and wrongful domination by Standard over the Debtor throughout the entire period of the Debtor's existence, Standard should be denied a claim as a creditor as a matter of law through the application of the Instrumentality Rule (II-290, I-132).

Hearing on the claim and objections thereto were referred by the District Court to a Special Master (I-65). Extensive proofs for both Claimant and Trustee were taken and

completed during a period of many months (II-1-376, 592-681, III-1-127). All of the witnesses who testified at these hearings were officers, directors or agents of Standard or its affiliates, including the operating officers of the Debtor (II-1, 19, 25, 31, 36, 55, 57, 62, 75, 100, 102, 107, 144, 145, 151, 223, 312-56, 606-8). None of the witnesses either expressed or indicated any hostility to Standard (II-377). Many of the salient facts were agreed upon in a comprehensive stipulation of facts (II-242-376). *Thus the entire evidence with reference to the Standard claim was substantially uncontroverted.*

b. *Nature of Standard Claim.*

From the inception of Deep Rock in 1919, up until the time of its receivership in 1933, Standard kept a so-called open account with Deep Rock (I-61-63). This open account consisted of book entries of debits and credits reflecting thousands of transactions between Deep Rock and Standard throughout this period. This open account shows a total of debit entries during this fourteen year period charged by Standard against Deep Rock exceeding fifty-two million dollars, offsetting which are credits totaling approximately forty-three million dollars, leaving a net debit balance of $9,342,642.37, which Standard claims to be owing from the Debtor (I-61-63).

The transactions reflected by this open account range from the expenditure of a few cents to transfers involving millions of dollars at a time (I-61-63, III-27-53). It includes thousands of charges for Deep Rock obligations and expenses paid by Standard directly to third persons (II-42, 57-8, 61, 78-93, 114-15, 172, 179, 184, 195-6, III-27-40, 41-53, 83-7). It also contains huge charges representing an apportionment to Deep Rock of Standard's business expenses, including expenditures for office rentals, salaries, bookkeep-

ing charges, auditing services, stationery, telephone bills and salaries and traveling expenses of various Standard officers (III-27-53). The open account also includes entries for some seventeen millions of dollars of cash advanced by Standard to Deep Rock which from time to time were repaid as shown by the credit entries (I-61-63).

However, by far the largest part of the open account consists of charges arising out of intercompany transactions between Standard and Deep Rock (I-61-63). Some twenty million dollars of these charges are under attack in these proceedings by reason of their fraudulent and wrongful nature which, if eliminated from the open account, would not only wipe out the entire Standard claim but leave Standard indebted to Deep Rock (I-335-346). In addition, it was urged that Standard had no right whatsoever to claim as a creditor of the Debtor by reason of the applicability of the Instrumentality Rule of law (I-328-30).

c. *Standard's Domination of Debtor.*

From this testimony, it appeared that Standard is one of the large public utility holding companies of this country, whose securities are listed on the New York Stock Exchange (II-603, 688-9). It carries on no business of its own except as it controls its subsidiary companies (II-7-8). Its published statements show consolidated balance sheets of itself and its subsidiary companies, in which total assets are listed at over one billion dollars (II-603, 688-9). The only subsidiary included in these consolidated statements that was not engaged in the public utility business was Deep Rock (II-602).

Standard incorporated the Debtor in 1919 and since early 1921, has owned between 95% and 98% of the common stock of the Debtor (I-260, II-635-41, 688-9). Standard has been alone during that period in the election and appointment of Deep Rock's officers and directors and in its control of the

Debtor, the common stock being the sole voting stock (II-385, 422, 629-31). The public preferred shareholders have had no voting rights and have at no time had any voice in the management, control or appointment of officers or directors of the Debtor (II-385, 422, 427-8, 629-31). The majority of the directors of Deep Rock were at all times officers and directors of Standard, and the remaining directors were operating officers of Deep Rock who were chosen by Standard and were subordinate to Standard's officers (II-325-56, 4-5, 9, 36, 41, 63, 70, 422, 427-8, 463). The top officers of Standard received their sole salary from Standard but at the same time acted as the top officers of Deep Rock (II-325-56, 5, 8, 145, 147, 151). Thus, there was complete interlocking of both officers and directors of the two companies.

The uncontroverted testimony discloses that all of the meetings and minute books of the Debtor's Board of Directors were held in the offices of Standard at Chicago, although the Debtor's principal place of business was at Tulsa (II-13, 37, 43, 162, 164-5, 178, 228, 240). At those meetings, the majority of directors present were, at all times, directors or officers of Standard and on rare occasions there were present a few of the operating officials of the Debtor (II-331-8, 608-629). Inasmuch as at all times the same persons were the top officers of both Standard and Deep Rock, the operating officers of the latter were at all times subordinates of the Standard officials present (II-312-359). Moreover, Deep Rock's chief operating officers were hired directly by Standard (II-4, 9, 63, 70, 36, 41). With reference to the hiring of John L. Gray, Deep Rock's vice-president and general manager, the President of Standard testified:

> "As President of Standard, I contracted with Gray as to the salary he was to receive as (Vice) President (of Deep Rock)" (II-9).

The uncontroverted evidence and written admissions herein, further disclosed that many of the most important transactions of the Debtor throughout the period of its existence, were handled directly by Standard without even the formality of approval by the Deep Rock Board and often without even written agreements (II-42, 28, 30, 78-93, 98, 144-51, 161-2, 172-173, 184-5, 195-6, 244-5, III-27-53). The uncontroverted testimony also disclosed that Standard handled all of the numerous financing of the Debtor, directly supervised the latter's accounting department, and for practical purposes operated the Debtor as a department of its own business (II-5-6, 9, 24, 26, 33, 37, 62, 69, 86, 233, 240, 380, 606-8, 652-76, 689).

The extent of Standard's direct operation of the Debtor is again shown in the testimony of Standard's officers that in the operation of Deep Rock

> "• • • no important moneys were spent or items approved without the approval of this (Standard's) Chicago office" (II-6).

They also testified that Standard's organization was "in daily touch" with the affairs of Deep Rock (II-33, 62), and "could, at a moment's notice, fill any executive capacity of Deep Rock" (II-69).

Many officials of Standard were also dummy officials of the Debtor although they were neither under salary nor allegiance to the Debtor. These dummy officials signed for the Debtor, checks for huge sums drawn on the Debtor's bank accounts but payable to Standard, notes for millions of dollars payable to Standard, and contracts with Standard involving many millions of dollars (II-42, 118-22, 144-51, 172-3, 179-80, 181-197, 201, III-1-5, 6-19). These dummy officials testified that they did not know why the contracts, notes and checks were signed or what their purpose was or whether there was any authorization therefor by the Deep

Rock Board of Directors (II-144-151). They testified that they signed for Deep Rock whatever instruments their superiors at Standard directed them to sign (II-144-151).

Typical of the testimony in this regard is the following quotation from the testimony of one of the Standard officers who signed a $4,250,000 note payable to Standard in his capacity as a dummy officer of Deep Rock:

> "Q. Do you have any recollection of that transaction?
> "A. No, sir.
> "Q. Do you know what the consideration for that note was?
> "A. No, sir.
> "Q. Do you know what was done with the $4,250,000?
> "A. No, sir.
> "Q. Do you know whether or not (Deep Rock) received that sum of money from the Standard Gas and Electric Company?
> "A. No, sir.
> "Q. Did you know at that time?
> "A. I don't remember now.
> "Q. By whose direction or authority did you sign the name of (Deep Rock) to that $4,250,000 note?
> "A. I don't recall that, now" (II-148-49).

At a further point in his examination, this dummy official admitted that in the signing of this note as well as many other Deep Rock notes payable to Standard, he was acting solely upon instructions from his superior officers at Standard (II-150-151). Other dummy officials of Deep Rock were not put on the stand when Standard's counsel conceded that their testimony as to the circumstances under which they signed Deep Rock notes, checks and contracts in transactions with Standard would be to the same effect (II-151).

The manner of Standard's operation of the Debtor is further evidenced by the fact that the entire proceeds of both a $7,500,000 and $10,000,000 Deep Rock note issue, sold to the public by Standard's affiliate and top-holding company,

H. M. Byllesby & Company, was pocketed directly by Standard (I-63, II-60-61, 97). Standard merely credited the Debtor's open account with the proceeds so taken after deducting heavy discount charges (II-60-61, 97).

Standard, itself, considered Deep Rock as a department of its own business (II-4, 5, 7, 10, 31). The Standard officials constantly referred in their testimony and documents to Deep Rock as being a part of the so-called "Standard System" or "Byllesby Group" (II-31, 62, 63, 87, 100-101, 156, 398). Standard's President, in referring to the acquisition of Deep Rock, testified:

> "So we got into the oil business that way" (II-4).

At a further point, he referred to services rendered by Standard for "all our properties, whether oil or public utility" (II-7). Deep Rock's assets and liabilities were moreover included in Standard's published reports as part of its "Consolidated Balance Sheet" (II-592-606). Deep Rock earnings were likewise included as part of Standard's "Consolidated Earning Statement" (II-592-606).

The uncontroverted testimony further disclosed that the Debtor was undercapitalized by Standard in the first instance; that it was in dire need of money throughout the entire period of its existence; and that it was in absolute dependence upon Standard for financial aid (I-146, 260, II-7, 16, 26, 30, 33, 35, 37, 41, 42, 73, 224, 229, 293, 405-6, 652-676, 677). The precariousness of the position of the Debtor throughout its existence is described by Mr. O'Brien, President of Standard, Byllesby and Company and Deep Rock, as a situation where the Debtor was constantly in danger of receivership, and was most of the time "two steps in front of the wolf" (II-16). Its utter financial dependence upon Standard inevitably subjected the Debtor and its officers to complete subserviency in its dealings with Standard.

d. *Fraudulent Refining Company Transactions.*

Deep Rock's subserviency to Standard was nowhere more evident than in the course of the so-called Refining Company transactions. By these transactions, Standard by its own fiat fraudulently divested Deep Rock of assets upon which Deep Rock had spent millions of dollars in acquisition, and at the same time foisted upon Deep Rock over five million dollars of fraudulent charges, which are included in Standard's claim on the open account (I-62, II-94-5, 130-3).

The uncontroverted testimony in this regard disclosed that in February, 1923, Deep Rock purchased certain oil properties known as the "Bradstreet Properties", which it continued to own and develop at its own cost and expense of over $2,200,000 (II-34-6, 44-6, 128-9, 176-7, 194-5, 227). Deep Rock operated these properties in the same manner as its other producing properties, without accounting to anyone for income therefrom and expending all sums necessary for operation thereof without charge to any one (II-35-6, 45, 72, 226-7).

In 1922, Deep Rock constructed a cracking plant as a necessary adjunct to its refinery to increase the production of its gasoline products (II-19-24, 26, 108-9, 218-22). This cracking plant was constructed on the refinery property of Deep Rock and in fact and appearance was an integral part of its refinery (II-108-9, 218-22, 226-7, III-148). It was operated by Deep Rock in the same manner as the remainder of the refinery (II-51, 108-9, 218-22). Its operation was entirely by employes of Deep Rock, with all income therefrom handled in the same manner as the income from the remainder of Deep Rock's refinery and all expenses therefor, paid by Deep Rock (II-51, 108-9, 218-22). In the construction of this cracking plant and improvements thereto, over $1,500,000 was expended by the Debtor (II-193).

The title to the Bradstreet properties and the cracking plant was nominally held by Deep Rock Oil and Refining Company (herein referred to as the "Refining Company"), a purely inactive dummy corporation, all of whose stock was owned by Deep Rock (I-113, II-36, 105-6, 191-2, 198, 294). After three years of operation of these properties by the Debtor as its own, the stock of the Refining Company was suddenly transferred to Standard solely upon directions of the General Auditor of Standard to his subordinates at Deep Rock (II-48-50, 128, 188, 606-8) with provisions made for crediting Deep Rock's open account with the latter's cost of acquisition (II-48-50, 128).

At the same time, a five year lease of these properties from the Refining Company to the Debtor was drawn by Standard officials and signed at Chicago by Standard officials in their capacity as dummy officials of Deep Rock (I-134-5, II-52, 148, 167, 230, 308, 606-8). Neither of the two officials who signed this lease in behalf of Deep Rock was under salary to Deep Rock and the only one of these officials who testified, stated that he knew nothing of this lease agreement nor why it was signed, except as it was common for him to sign Deep Rock instruments at the direction of his superior officers at Standard (II-148, 151).

This lease, so executed by the Standard officials in their capacity as dummy officers of the Debtor was, on March 19, 1926, mailed to Tulsa from Standard's office in Chicago with instructions from the Standard Auditor that it should be signed under date of October 1, 1925, by two of the operating officers of Deep Rock in their capacity as dummy officers of the Refining Company (II-52).

By this lease, it was provided that Deep Rock was leasing from the Refining Company these very assets which Deep Rock had owned and operated for over three years and purchased, constructed and developed with its own funds (I-134-5). The lease furthermore provided that Deep Rock

should pay a rental to the Refining Company of $600,000 per year (I-134-5). These rentals were admittedly grossly exorbitant (II-391, 429-32). It is admitted that Deep Rock paid these rentals not to the Refining Company, but directly to Standard (II-94-5, 152-3). In addition, Standard charged Deep Rock some $190,000 for Federal Income Taxes on Standard's profits from these rentals on the wholly fraudulent assumption that that was another Deep Rock obligation under this lease (II-81-2).

The lease further provided that Deep Rock should pay all costs of operation and acquisition of new properties and additions which would then belong to the Lessor (I-134-5). After the making of the lease, Deep Rock spent several million dollars more of its own money in acquiring new properties which Standard now claims to be the property of the Refining Company (I-134-5, II-176-7, 192-3, 391). Despite Deep Rock's tremendous losses on this deal during the five years of this lease, the lease was renewed at its expiration for another five years on the same terms and through the medium of the same dummy officials (I-136-7, II-229-30, 244, 429-32, III-23-4).

It is admitted by Stipulation of Standard that neither this lease nor its renewal of October 1, 1930, was ever approved by or even submitted to the Deep Rock Board of Directors (II-244). It is further admitted by Standard that, although two-thirds of the rental charged under this lease was attributable to the leasing of the cracking plant to Deep Rock, the written instrument itself completely omitted any mention or description of the cracking plant (III-23-24, II-244).

By these Refining Company transactions, Standard stole from the Debtor assets on which the Debtor has spent over four million dollars of its own funds (II-176-7), leased them back to the Debtor, the owner of the assets, and by this lease, foisted on Deep Rock about five and one-half million dollars

of fraudulent rental, income taxes and interest charges which are part of the open account on which Standard's claim is based (I-62, II-81-2, 131-133).

These Refining Company transactions were not only condemned in the dissenting opinion of Circuit Judge Bratton (I-504) but were likewise recognized in the Majority opinion of Circuit Judge Phillips as transactions in which "Standard exercised its control to the benefit of Standard and to the detriment of Deep Rock" (I-482). These transactions were likewise characterized by the Attorney for the Trustee as "unconscionable" and "fraudulent" (II-391).

The significance of this unanimous version of the fraudulent nature of the Refining Company transactions lies in the fact that these were not merely isolated or insignificant instances of Standard's abuse of its control over the Debtor. On the contrary, these transactions were an aggregate of innumerable machinations by Standard throughout the major period of the Debtor's existence. Moreover, these admittedly fraudulent transactions account for over five million dollars of the debit charges that are included in Standard's open account as the basis for its claim against Deep Rock (I-62, II-81-2, 131-3).

The unanimous finding by the Circuit Court of Appeals of the wrongfulness of the Refining Company transactions is of itself, we submit, an irrefutable adjudication that in its operation of the Debtor, Standard grossly and fraudulently abused its power of control over its instrumentality subsidiary. It is submitted that this finding of fact calls as a matter of law for the application of the Instrumentality Rule, as recognized by this Court and by the weight of authority, in denial of Standard's entire claim as a creditor of Deep Rock.

e. *Fraudulent Management Charges.*

The uncontroverted testimony further disclosed that over $1,200,000 of the Standard claim against Deep Rock is

based upon charges by Standard's wholly owned affiliate, Byllesby Engineering and Management Corporation, for supervision and management of the Debtor, by the same officials who, at the same time, were also the top officers of Standard and the Debtor (I-62, II-3, 7-8, 28-9, 55, 101, 239, 433-4). These officials admitted that they knew nothing about the oil business and claimed to know nothing and, in fact, performed no services other than advice on the financial difficulties of the Debtor (II-4, 5, 7, 9-10, 14-16, 27, 29, 40, 41, 55-59, 227-8, 239).

It is admitted by Standard that no contract for these charges was ever made, either orally or in writing, and that the matter was never submitted to the Deep Rock Board (II-28, 244). The charges were entirely dictated and directed by the Standard officials in their capacity as officers of the said Management Company (II-28). None of the witnesses could give any basis for the making of these charges or how the amounts were arrived at (II-7, 25-26, 27, 239). It was admitted by the Vice-President of Standard's own affiliate and top holding company that these charges were made for services that were never rendered and were unwarranted in their entirety (II-433-4). These Management Company charges were likewise characterized by the Attorney for the Trustee as a "fraud" and as "wholly unjustified", after the close of the proofs on the Standard claim (II-391).

f. *Wrongful Dividend Withdrawals.*

Over four million dollars in Deep Rock dividends were declared to Standard (I-61, II-88-9). Although the books of the Debtor showed a surplus by reason of earnings (II-649-50), nevertheless, it is admitted that the records of Deep Rock's income and earnings filed with the Federal Government as part of Standard's consolidated income tax return disclosed that, in fact, Deep Rock had neither sur-

plus nor earnings from which to pay any dividends (III-90-93). It is also shown by the uncontroverted evidence that Deep Rock never had the cash to pay these dividends to Standard, and had to borrow from Standard through the medium of the open account in order to pay them (I-61, II-7, 16, 26, 35, 37, 88-9, 224). This open account indebtedness for dividend charges was, we submit, clearly illegal and unwarranted.

g. Illegal Compound Interest and Discount Charges.

The uncontroverted testimony further disclosed that, included in the Standard Claim is $4,819,222.07 of interest, charged by Standard against Deep Rock on the average daily balances of this open account at the rate of seven per cent per annum (I-61). These interest charges were added at the end of each month to the open account as an additional indebtedness on which interest was thereafter charged, thereby resulting in illegal compounding of that interest (I-61, II-86-7). Moreover, the major part of these interest charges arose out of Deep Rock's indebtedness on the many wrongful and fraudulent charges imposed by Standard and included in the open account. Were it not for these fraudulent and wrongful charges, there would have been no balance owing to Standard and hence no interest to be charged.

It is admitted by Standard that there was no written agreement covering the charging of this interest and that the matter of the making of these charges was never submitted to or approved by the Deep Rock Board of Directors (II-86-88, 161-2). In addition, millions of dollars of underwriting fees and discounts were charged by Standard against the Debtor without any written agreement or authorization by the Deep Rock Board of Directors (I-61-3, 447-8, II-60, 87-8, 143, 148-151). The total of these illegal

and extortionate interest and discount charges contained in the Standard claim is well over six million dollars (I-61, 447-8).

h. *No Proofs on Fairness of Standard Charges.*

The undisputed testimony further disclosed many other instances of wrongful charges and unconscionable transactions included in Standard's charges against Deep Rock, as well as the manner and method of Standard's handling of the Debtor as a department of its own business and to suit its own ends unmindful of the best interests of Deep Rock's security holders. In presenting its claim, Standard made no attempt at proving the fairness of the charges against Deep Rock included in the open account but contented itself with showing that the charges so made were shown on the books of both Standard and Deep Rock (II-59-61, 267, 437, 543-7).

It is admitted that the entries on Deep Rock's books were directed by Standard's Auditing Department (II-62, 240). It would indeed be surprising if the two sets of books did not agree (II-545-6). It is also conceded that there were many large transactions between Deep Rock and Standard and its affiliates that did not clear through the open account and the propriety of which has never been exposed to inquiry (II-74-5, 89, 123).

We submit that the existence of the many fraudulent transactions brought to light in the course of this hearing, and the admittedly interlocking nature of the relationship between Standard and Deep Rock, should have at least required the submission of an impartial and competent audit of all of Standard's dealings with Deep Rock. It is admitted, however, that *no independent audit has ever been made of the transactions between Deep Rock and Standard and its affiliates* (II-525, 437).

i. *Standard Treats Open Account as Capital Investment.*

Although Standard now urges that it is a creditor of Deep Rock by virtue of this open account, the fact is that, prior to Debtor's receivership, Standard itself treated this open account as merely a part of its capital investment in Deep Rock. Standard's entire treatment of the open account and the unusual nature of the transactions reflected therein bore none of the usual attributes of a debtor-creditor relationship.

It is admitted, for instance, that Deep Rock never entered into any agreement for the repayment of these open account balances, nor was any time of repayment even discussed (II-65, 241). The fact is that Standard distinctly recognized these open account balances as part of its capital investment in Deep Rock when, in 1928, it cancelled approximately eleven million dollars of open account balances for which it took additional common stock of Deep Rock, although at the time, it already owned practically all of the Debtor's common stock and hence was not increasing its ownership in the Debtor's assets (II-624, I-59-60). Other instances of Standard's treatment of this account as a part of its capital investment in the Debtor appear in the Record (II-89, 273-5, III-105, 118, 120, 127).

j. *Standard's Manipulation of Deep Rock Securities.*

The uncontroverted evidence further discloses that the notes and preferred stock of the Debtor were sold to the public by Standard and its top-holding Company, Byllesby & Company (II-11, 114, 420). Byllesby & Company acted as both principal and agent in its dealings with the public in the sale and purchase of Deep Rock notes and preferred stock (II-421). From the outset it maintained a controlled market for these securities and uncontradicted evidence

points to fraudulent manipulation of the prices (II-421, 508-11, 642).

The evidence further discloses that in selling Deep Rock securities to the public, representations as to the valuations of the Debtor's assets showed amounts that were far in excess of the true valuations and were four times the valuation now claimed by Standard in the appraisal of these assets in the instant case (II-254, 297, 593-605, III-103-114). The undisputed testimony further discloses that in the sale of these securities representations were made as to the tremendous earnings by the Debtor at a time when its Federal income tax reports were disclosing heavy losses (II-254-62, 297-301, 593-605, III-103-114, 90-93). Similarly, the annual reports to the Deep Rock security holders, published by Standard, grossly and unconscionably misrepresented the valuations of the Debtor's assets, as well as the amount of its earnings (II-593-605, III-103-114).

The further uncontroverted evidence discloses that the prospectuses prepared and circulated by Standard, upon which the Deep Rock notes were sold to the public by Standard and by Byllesby & Company, both in 1926 and 1928, set forth that the Cracking Plant was owned by Deep Rock, although Standard, as a part of its claim herein, maintains now that the Cracking Plant was at that time owned by itself, as sole owner of the Refining Company's stock (II-258, 297).

We submit that under the undisputed evidence, there is no room for doubt that throughout the entire history of Deep Rock, Deep Rock's security holders were preyed upon by Standard, not only by its fraudulent looting of Deep Rock's assets, but further by its fraudulent manipulation of the market values of these securities.

k. *Summary of Proofs on Standard Claim.*

Thus, we submit, the uncontroverted facts in the trial on the merits of the Standard claim disclose that Deep Rock

was completely dominated by Standard throughout its existence; that it was operated as a department of Standard; that Standard grossly abused its control over the Debtor; that Standard fraudulently manipulated the Debtor's securities; that the open account balance shown owing to Standard is at best a part of its capital investment in the Debtor; and that, in the light of the admitted and uncontroverted facts disclosed by this Record, the Debtor was a mere instrumentality of Standard. It is submitted that, as a matter of law, those facts call for the application of the Instrumentality Rule in denial of Standard's entire claim as a creditor of Deep Rock. (See Brief herein for citations of authority.)

We further submit that the uncontroverted testimony discloses that aside from the application of the Instrumentality Rule, Standard has no valid claim because the specific items of wrongful and fraudulent charges included in Standard's claim against Deep Rock total over twenty million dollars (I-335-47). If but half of those wrongful charges are eliminated from the open account, the claimed indebtedness of the Debtor to Standard is entirely wiped out.

The facts hereinabove discussed were developed in the trial before the Special Master on the merits of the Standard claim. All proofs at that trial were closed on February 13, 1935, when both the Trustee and Standard rested their case (II-241-2). No decision was rendered, however, either at that time or at any time since.

4. Formation of Respondent Reorganization Committee.

Meanwhile, immediately after the inception of the receivership of the Debtor, Byllesby and Company, top-holding company controlling Standard, initiated the Respondent Reorganization Committee to represent holders of both notes and preferred stock (II-312, 395, 423-4, 465, 717). This Committee was and is headed by John J. Shinners, as

Chairman (II-717, 819). Mr. Shinners is a Vice-President of Byllesby and Company and testified that Byllesby and Company picked the entire personnel of the Reorganization Committee (II-423-4).

A Plan of Reorganization was first promulgated by the Reorganization Committee in August, 1934, hereinafter referred to as the "First Plan" (II-819) and requisite consents therefor were obtained by January, 1935 (I-138-42). Under this First Plan, Deep Rock's preferred shareholders were to be wiped out, and a new two and one-half million dollar issue of preferred stock was allocated entirely to Standard (II-823). In addition, Standard was to receive seventy-five per cent of the new common stock of the reorganized Company, with a little less than ten per cent of the common stock to be allocated to the preferred shareholders of the Debtor in full satisfaction of their rights (II-823). The Plan provided that the allocation to Standard was predicated on the assumption that Standard would succeed in establishing its claim as a creditor of the Debtor in the amount of at least five million dollars (II-824-5). Prior to presentation of this First Plan for confirmation, it was therefore necessary for Standard to secure allowance of a five million dollar claim.

5. First Compromise Proposal for Allowance of Standard Claim at Five Million Dollars Rejected.

On February 21, 1935, John M. Taylor and Wm. H. Taylor, holders of five hundred and fifty shares of preferred stock intervened in the 77-B proceedings (I-99-102). The Taylors, who were the predecessors of petitioners, had purchased these shares in 1928 on the recommendation of Byllesby & Company at a cost of forty-eight thousand dollars (I-316, II-510). Upon their intervention, they filed objections in behalf of themselves, as well as the holders of preferred shares as a class, to the allowance of the Standard

claim in any amount whatsoever for the reasons hereinbefore set forth (I-96-99, 335-447).

Shortly thereafter, on March 8, 1935, the Trustee of the Debtor submitted to the District Court with his recommendation for approval, an offer of compromise by Standard calling for the allowance of its claim in the amount of approximately five million dollars, hereinafter referred to as the "First Compromise Proposal" (I-102-7). The District Court ordered a hearing on the propriety of the acceptance of this first compromise proposal before the same Special Master who had heard the completed proofs on the merits of the Standard claim but had not yet filed his findings of fact and law (I-107). At the hearing before the Special Master, acceptance of the compromise proposal was recommended and urged by the Trustee of the Debtor, by Standard, and by the Reorganization Committee (II-376-400, 380, 400, I-200). The Taylors, alone, opposed its approval (I-200). At the close of this hearing, the Special Master recommended acceptance of this first compromise proposal (I-201-2).

The matter then came on before the District Judge on September 23, 1935, for hearing on the Taylors' Exceptions to the Special Master's Report (I-211, II-400). During the course of this hearing, Judge Ramsey, Attorney for the Trustee, although he recommended the approval of this compromise (I-105-107, II-380), admitted to the Court what had been disclosed by the uncontroverted testimony in the course of the hearing on the merits of the Standard claim (II-403-6). He stated in part:

> "Now there isn't any doubt that the Standard has manhandled this Deep Rock. As Lord Brougham once said: 'It was the proud boast of Augustus that he found a Rome of brick and left it of marble.' The Standard found the Deep Rock an unsophisticated country maiden and left it a harlot. There isn't any doubt but what the Standard has absolutely manhandled the Deep

> Rock. • • • This Deep Rock Company made one hundred and ninety-two million and some odd dollars in thirteen years, and its net profit was a little over ten million. Now that on its face shows that it has been manhandled. Talk about a corporation making one hundred ninety-two million plus in ten years and having only ten million dollars plus in net profits. That on its face shows it has been run in a harum scarum way" (II-403-406).

At the conclusion of this hearing, the District Judge set aside the Special Master's findings and completely rejected this first compromise proposal, on the basis that the objections of the Taylors urging the disallowance of the entire Standard claim were "sustained" (I-244-5). In the course of his opinion rendered in open Court, the District Judge said, in part:

> "The Court: Here is the situation. You cannot get $10,000,000 noteholders and $5,000,000 worth of preferred stockholders, it is hard to get them to concentrate in a unified fight for their interest, whatever it may be. They are scattered all over the country. • • •
>
> "Now there is no need to go any further with this argument. I am thoroughly convinced. I have been studying this case, and that is the reason I had it set down for further argument, my conscience wouldn't let me approve this compromise from just hearing the arguments. Here is $5,000,000 worth of stock outstanding; somebody got that money from the public. Now under this settlement if I was to approve it, and in approving the plan of reorganization I would just as well say to the (preferred) stockholders, you are wiped out; you get a little piece of paper called common stock that I wouldn't give one cent for. • • •
>
> *"The evidence is overwhelming the Standard ran this company; they officered it; they capitalized it; it is just a child in their hands, and if there ever was a case the law is clear on, it is nothing in the world but an instrumentality, according to the admissions.* • • •

"Now I am just indicating to you the things I think will be reasonable, and may be it will help you out, but if you cannot reach a settlement, I will enter an order denying the claim on the ground that the instrumentality rule applies" (II-406-7).

Thus, the District Court rejected the first compromise proposal on a finding that the Standard claim was invalid in its entirety. Were it not for the rejection of the first compromise proposal at the instance of the Taylors, the first Plan of Reorganization with its complete elimination of the preferred shareholders, would have been adopted (I-244-5).

6. Second Compromise and Amended Plan Approved.

A period of over a year from the time of the rejection of the first compromise proposal then elapsed, with no action taken towards adjudication on the merits of the Standard claim. Notwithstanding the District Judge's finding as to its invalidity, the Standard claim has never since been adjudicated on its merits, despite the Taylors' and Petitioners' insistence on such an adjudication (I-245, 328).

On November 9, 1936, without even conferring with the Taylors who had been the sole objectors to the first compromise, Standard came in with a so-called new offer of compromise of its claim, hereinafter sometimes referred to as the "Second Compromise Proposal" (I-296, II-731-4). By this second compromise proposal, it was again proposed that the Standard claim be allowed at five million dollars, although exactly such an allowance had already been rejected in the first compromise proposal (I-105-7, II-731-4). At the same time, the Reorganization Committee came in with a proposed Amended Plan of Reorganization which was made by its terms a part of Standard's new compromise proposal (I-276, II-717).

a. *Terms of Amended Plan.*

Under the Amended Plan, the Debtor is to have a new capital structure of ten million dollars of notes and 520,000 shares of common stock, allocated as follows (II-722):

(1) NOTEHOLDERS are allotted all of a new issue of ten million dollar six per cent income debentures in lieu of the present issue in the same principal amount. For interest accumulated to January 1, 1937, in the total amount of $2,300,000, the noteholders are to receive $1,200,000 in cash and 40,000 shares of the new common stock. All interest subsequent to January 1, 1937, is to be paid in cash (I-378).

(2) PREFERRED SHAREHOLDERS are eliminated from their preferred position and in full satisfaction of their present seven million dollar right of participation in the Debtor's assets, they are allotted one hundred thousand shares of the new common stock.

(3) STANDARD receives, for its five million dollar claim, three hundred and eighty thousand shares of the new common stock. It receives presumably nothing for its ownership of the present common stock of the Debtor.

Thus, Standard is allocated approximately seventy-three per cent of the new common stock, as against nineteen per cent to the preferred shareholders, with the remaining eight per cent allocated to the noteholders.

b. *Formation of Petitioners' Committee.*

This Second Compromise Proposal and Amended Plan was set for hearing before the District Judge on December 12, 1936 (I-288, 299). In the meantime, about the middle of 1936, the Taylors had caused the formation of the Independent Committee for the Protection of the Holders of Preferred Stock of Deep Rock, petitioners herein, who

thereupon intervened in the case and were substituted as Intervenors in the place of the Taylors (I-311-327, 357-8). At the hearing of December 12, 1936, petitioners, as representatives of the public holders of 10,295 shares of preferred stock, being in excess of twenty per cent of the entire issue, presented their written objections to the Amended Plan and Second Compromise in behalf of the preferred shareholders as a class (I-33-4, 328-54, 420-24).

c. *Petitioners' Objections to Second Compromise and Amended Plan.*

The objections of petitioners to the Amended Plan and Second Compromise were substantially as follows (I-328-54, 420-24):

(1) That the compromise allowance of the Standard claim at five million dollars was unwarranted inasmuch as the Standard claim was invalid in its entirety as disclosed by the substantially uncontroverted evidence in the completed hearings on the merits of this claim.

(2) That the District Court had already adjudicated the invalidity of the entire Standard claim at the time of the rejection of the first compromise proposal, and in any event had adjudicated that a compromise allowance of that claim at five million dollars was unwarranted.

(3) That the compromise proposal was contrary to the best interests of the preferred shareholders and was unduly favorable to Standard.

(4) That the Plan of Reorganization was based on an unfairly low appraisal of the Debtor's assets, which resulted in an unfair and inequitable discrimination in favor of Standard at the expense of the preferred shareholders, in the allocation of the equity in the Debtor's assets.

(5) That the offer and acceptance of the Plan was in bad faith for the purpose of enhancing Standard's interests at the expense of the preferred shareholders.

d. *Proofs Show Second Compromise Unfair.*

At the hearing, Standard and the Reorganization Committee urged acceptance of the Amended Plan and Second Compromise proposal but produced no proofs in justification of the compromise allowance of Standard's claim at five million dollars. The Chairman of the Reorganization Committee, Mr. John J. Shinners, Vice-President of Byllesby & Company, admitted that the Reorganization Committee knew nothing of and did not concern itself with the propriety of the compromise proposal (II-446, 448, 449, 451).

He stated that the Reorganization Committee urged acceptance of the compromise solely in reliance on the recommendation and approval of the Trustee (II-448). It appeared moreover that, prior to the hearing, a letter had been sent to the security holders by the Reorganization Committee urging them to refrain from joining with petitioners in opposing the compromise proposal. This letter read in part:

> "The Trustee of Deep Rock and his Counsel have approved the new compromise" (II-683).

The Trustee and his counsel, however, specifically belied the testimony of Mr. Shinners and the representation made in this letter when they stated in open court that they were making:

> "No recommendations here on behalf of the Trustee to either accept or reject the compromise" (II-524).

Thus, neither the Reorganization Committee nor the Trustee attempted to justify the fairness or propriety of

this compromise allowance of Standard's claim. Standard alone urged the acceptance of this compromise allowance of its claim. However, even Standard offered no testimony whatsoever on the fairness of such compromise.

The only proofs with reference to the propriety of the compromise allowance were those offered by petitioners in opposition to it. Petitioners offered in evidence the entire record in the completed hearing on the merits of the Standard claim, which was accepted by the District Judge as part of the proofs before him, and has been included as part of the Record in this case on appeal (II-556-7). In addition, petitioners produced additional testimony, including a full cross-examination of the Chairman of the Reorganization Committee, supplementing the Record on which the District Court had rejected the first compromise proposal (II-419, 469, 508-514, 542-555).

Moreover, the unfairness of the compromise was made even more apparent by the appraisal which the proponents of the Plan submitted and which was approved by the District Judge. This appraisal fixed a total valuation of approximately seventeen million dollars on the Debtor's assets (I-359-61). There being some twelve million dollars owing to the noteholders for principal and interest, there was left only a five million dollar equity to be shared by Standard and the preferred shareholders. With Standard being allowed a claim for five million dollars, no equity was left for the preferred shareholders. Thus, the preferred shareholders were as completely eliminated by the compromise allowance of the Standard claim at five million dollars as they would be by the allowance of the entire Standard claim at some nine million dollars. The compromise was thus clearly contrary to the best interests of the preferred shareholders and was beneficial only to Standard.

At the close of this hearing, the District Judge approved the compromise but rendered no opinion, either written or oral in support of his adjudication (I-393-6). Nor did he make any attempt to explain or reconcile his approval of this compromise in the face of his former rejection of exactly the same compromise amount, and particularly in the face of his own finding that the entire Standard claim was invalid.

e. *Proofs Show Amended Plan Unfair.*

On the fairness of the Plan as a whole, the only testimony offered by its proponents was that of Mr. Shinners, Vice-President of Byllesby & Company and Chairman of the Reorganization Committee (II-411-19). He admitted that the same Standard officials, who were also the top officers of the Debtor, are his superior officers at Byllesby and Company (II-422-3, 433). The extent of his partisanship for Standard was shown during the course of his entire cross-examination at this hearing (II-419-467, 508-514). At one point he was asked whether he knew that the testimony on the Standard claim showed gross misrepresentations by Standard to Deep Rock security holders. Mr. Shinners characteristically replied:

> "If you are asking me to impeach and try my associates with respect to their integrity, Mr. Honigman, I am not going to do it" (II-462).

On the whole his testimony disclosed many evasions and contradictions. His entire basis for supporting the fairness of the Plan was his explanation that the Plan was fair provided that Standard had a valid claim for five million dollars and provided that the appraisal of the Debtor's assets was a fair one (II-444-453). At best, his testimony merely begged the basic questions in issue.

(1) Appraisal of Debtor's Assets.

Other than the testimony of Mr. Shinners, the only evidence introduced by the proponents in support of the fairness of the Plan was the testimony dealing with the so-called Trustee's appraisal of the Debtor's assets. No dispute is here involved with reference to the fair value of the Debtor's current assets which consist mainly of cash and which total a net amount, over and above current liabilities, of approximately $7,300,000 as of October 31, 1936 (I-361).

With reference to the fixed assets, the valuation of which is in dispute, the proponents of the Plan presented an appraisal at this hearing (I-358-361). This so-called "Trustee's Appraisal" was admittedly prepared, not by the Trustee of the Debtor, but by the operating heads of the various departments of the Debtor (II-526, 484). These operating heads had been hired originally by Standard (II-519). Under the proposed plan, they would again find themselves in the employ of Standard (II-463).

This Trustee's Appraisal disclosed a valuation of approximately nine and one-half million dollars for the fixed assets (I-359-361). *Admittedly, however, it did not take the earnings or earning power of the Debtor into consideration* (II-501, 504, 528-9, 566). The earnings of the Debtor have been very substantial, amounting to over one hundred ninety-two million dollars of gross earnings in the fourteen year period of its existence prior to its receivership (II-649). Since receivership, the Debtor has accumulated from earnings over four million dollars in cash, as well as millions of dollars in additions and improvements to its fixed assets (II-519, III-132).

This Trustee's appraisal was by far the lowest appraisal ever submitted of the Debtor's fixed assets. It was but a fraction of the values arrived at in former appraisals by the same Standard employes (II-102, 193, 534-5, III-125)

(I-43, II-595-605) (II-676-9). The last statement published by Standard for distribution to Deep Rock's public security holders showed a book valuation for the fixed assets of Deep Rock in excess of forty-four million dollars (III-113), as contrasted with the present Trustee's appraisal of nine and one-half million dollars for these same assets after admittedly substantial improvements since receivership.

Moreover, the Trustee of the Debtor had admittedly made an appraisal in 1933, subsequent to receivership, in which he evaluated the Debtor's fixed assets at approximately thirteen million dollars (II-412-14, III-146). In the course of his testimony, the Trustee admitted under cross-examination that the fixed assets of the Debtor were now worth between three and four million dollars more than they were at the time of his 1933 appraisal (II-519). *Based on the Trustee's former appraisal, the present value of the fixed assets would be at least sixteen million dollars, instead of the nine and one-half million dollars now claimed. Although his former appraisal was put into evidence at this hearing, the Trustee offered no explanation for this gross discrepancy.*

The only witness who appraised the fixed assets of the Debtor in the light of its earnings and earnings power was the expert witness produced by petitioners (II-551-555). He appraised the fixed assets at thirteen million six hundred thousand dollars (II-554). That this appraisal was a conservative one, is evidenced by the fact that it was far lower than any appraisal ever made of the Debtor's assets with the single exception of the present Trustee's Appraisal (III-125, II-102, 193, 534-5) (I-43, II-595-605) (II-676-9) (III-130) (III-146, II-519, 512-14) (II-781-2, 537-40).

Petitioners' appraisal showed a total value of the Debtor's current and fixed assets at $21,600,000 (II-554). On petitioners' appraisal, there is sufficient value in the Debtor's assets to pay $12,300,000 for principal and interest

in full to the noteholders, as well as $5,000,000 to Standard, assuming it has a valid claim in that amount, and still leave an equity of approximately $4,000,000 for the preferred shareholders.

The proponents of the Plan justify the practical elimination of preferred shareholders from participation in the assets of the Debtor by claiming that under the present seventeen million dollar "Trustee's Appraisal", there is no equity left for preferred shareholders after the noteholders and Standard's five million dollar claim are taken care of. Thus, through the device of an unfairly low appraisal, that admittedly omits all consideration of earning power, the rights of the preferred shareholders are obliterated. Nevertheless, the District Judge accepted this palpably low and unfair appraisal, without any opinion or explanation (I-393) and in the face of his own statement in open court that this appraisal was low by reason of its failure to consider the Debtor's earnings (II-566).

Respondent Reorganization Committee voted in approval of the Amended Plan approximately 83% of the notes and 58% of the preferred stock of the Debtor (II-579). The testimony in the hearing before the District Court developed that the largest individual preferred shareholders of the Debtor had joined in acceptance of the Plan for selfish reasons of their own, and were not concerned with the best interests of the preferred shareholders as a class. A discussion of the facts in this regard appears in the Brief accompanying this Petition.

f. *District Court's Approval of Second Compromise and Amended Plan.*

At the conclusion of this hearing, the District Judge, without written or oral opinion, entered orders approving the compromise allowance of the Standard claim at five million

dollars and confirming the Amended Plan of Reorganization (I-363, 393). Petitioners appealed from these orders to the Tenth Circuit Court of Appeals under both Sections 25 and 24-B of the Bankruptcy Act (I-1-15, 436-64). These appeals were there consolidated (I-17-21).

7. Decision of Circuit Court of Appeals.

The Circuit Court of Appeals affirmed the decision of the District Court by a divided Court (I-477-505). Separate opinions for the majority were rendered by Circuit Judges Orie L. Phillips and Robert L. Williams (I-477, 499). A dissenting opinion was rendered by Circuit Judge Sam G. Bratton (I-500-505).

Both majority opinions refused to pass upon the validity of the Standard claim on its merits (I-492, 499). The gist of both majority opinions is that they saw no reason to disturb the discretion of the District Judge in approving the compromise allowance of the Standard claim, and confirming the Plan of Reorganization of which it was a part.

Both majority opinions, and particularly the opinion of Circuit Judge Williams, place great reliance upon off-the-record evaluations of local counsel, the attorney for the Trustee and the Special Master, both of whom had recommended the first compromise proposal for the allowance of the Standard claim at five million dollars (I-490, 499). The fact is, however, that neither of these Attorneys had made any recommendations whatsoever on the Second Compromise Proposal. The latter compromise was never submitted to the Special Master, and the Attorney for the Trustee admitted in open court that he was making no recommendations (II-524). Moreover, no explanation is made in either of the majority opinions as to why the earlier recommendations of those individuals should be given any weight, when the District Judge had already rejected those recommendations at the hearing on the first compromise proposal, in

language so strong as to characterize the rejection as one impelled by the District Judge's "conscience" (II-406).

The opinion of Circuit Judge Williams makes no attempt to analyze the facts of the instant case. The opinion of Circuit Judge Phillips, however, goes into a lengthy discussion of the facts, but, we submit, it shows a grave misconception of the facts on some of the basic points in issue and also fails to mention many salient facts that appear from undisputed testimony. For example, the opinion of Circuit Judge Phillips omits all mention of the fraudulent Management Corporation fees, the illegal and extortionate compound interest and discount charges, Standard's fraudulent manipulation of the Debtor's securities, and the many bad faith practices of the Respondent Reorganization Committee.

Then, too, Circuit Judge Phillips finds that in the Refining Company transactions, "Standard exercised its control to the benefit of Standard and to the detriment of Deep Rock" (I-482). We submit, however, that his opinion fails to recognize the significance of that finding. As we have hereinbefore pointed out, the Refining Company transactions were not isolated or insignificant instances of the abuse of Standard's control over the Debtor. On the contrary, they represent a major portion of Standard's dealings with the Debtor over the greater part of the latter's existence. These transactions were a continuous series of dealings, whereby Standard, over a period of ten years constantly imposed on Deep Rock many millions of dollars of fraudulent charges, and diverted assets belonging to Deep Rock running into millions of dollars. In the face of such an admitted situation, it is merely giving lip-service to the Instrumentality Rule to recognize its existence and at the same time to refuse to apply it in denial of Standard's claim as a creditor in the instant case.

Another important misconception of the facts appears in Circuit Judge Phillips' opinion in the course of discus-

sion of the appraisal, upon which his approval of the Plan is predicated. He says (I-498):

> "There was no showing that in making the appraisal any pertinent factor was disregarded. Due consideration was given to going concern value."

The record itself clearly contradicts this finding. The sole expert witness produced by the proponents of the Plan in support of this appraisal, testified under cross-examination:

> "Q. But the net earning power of the whole picture has not been taken into account, has it?
> "A. Not by me.
> "Q. Did they produce any figures to you on which you could take it into account?
> "A. No, sir.
> "Q. So that that element, which to a purchaser would be one of the chief elements in purchasing, is not reflected in the appraisal on file here?
> "A. That is true." (II-504).

The Trustee of the Debtor likewise acknowledged that no consideration had been given to earnings or earning power of the Debtor in the computation of this appraisal (II-528-9). Moreover, the District Judge himself, at the close of the proofs on this appraisal, stated in open Court:

> "The Court: There is no doubt you have a low appraisement. It is a very conservative appraisement, because your testimony established you didn't pay any attention to the earning power" (II-566).

Thus, Circuit Judge Phillips' findings concerning this appraisal are clearly contrary to the undisputed facts. In the face of those undisputed facts, the Trustee's appraisal was, we submit, an improper one under the decisions of this Court and the decided weight of authority, discussion of which is contained in the Brief presented herewith.

Circuit Judge Bratton, in his dissenting opinion, unequivocally held that the Standard claim as a creditor was invalid in its entirety by reason of the applicability of the Instrumentality Rule (I-504). He further held that in view of the invalidity of the Standard claim, the Plan of Reorganization was necessarily unfair and inequitable and the orders of the District Court should be reversed (I-504-5).

The decree of the Circuit Court of Appeals affirming the District Court's orders was entered on April 27, 1938 (I-505). Petition for rehearing was filed by petitioners on May 25, 1938 (I-507) and was denied on June 6, 1938 (I-527). From the decision of the Circuit Court of Appeals, this Petition for Certiorari is taken.

B. Reasons for Granting Certiorari.

1. Application of the Instrumentality Rule in 77-B Proceedings.

The decision of the Circuit Court of Appeals is in conflict with the applicable decisions of this Court and the decided weight of authority in refusing to apply the Instrumentality Rule to deny the parent company's claim as a creditor against its instrumentality subsidiary. The facts calling for application of the Instrumentality Rule in the instant case are substantially uncontroverted, leaving for decision only the legal question of the applicability of the Instrumentality Rule to those facts. The Instrumentality Rule is a highly important rule of law that is far-reaching in its application to intercorporate relationships. It is of particularly widespread importance and significance in view of the very many large corporations of this country that seek reorganization in 77-B proceedings under circumstances where, as in the instant case, participation in the reorganization plan is predicated upon the establishment of large claims between interrelated corporations. By reason of the

expanding importance of the Instrumentality Rule, the further delineation of its applicability in reorganization proceedings is worthy of consideration by this Court.

2. Unfair Appraisal in 77-B Proceedings.

The decision of the Circuit Court of Appeals is in conflict with the applicable decisions of this Court and the decided weight of authority in confirming a plan of reorganization which is based on an unfair and prejudiced appraisal of the Debtor's assets which admittedly omits all consideration of earnings or earning power of the Debtor. By means of such unfair appraisal, the equity of a five million dollar class of public preferred shareholders has been eliminated. The importance of a fair, disinterested and proper appraisal in arriving at a fair plan of reorganization can scarcely be overestimated and has often been acknowledged by this Court in equity receiverships. It is a matter of great public importance that this Court define the requirements of a fair and proper appraisal in reorganizations under Section 77-B.

3. Abuses of Public Utility Holding Companies.

This Court should undertake to pass upon the highly important public question of the practices of many public utility holding companies in looting the earnings and assets of their subsidiaries by foisting upon them illegal and unwarranted charges. The uncontroverted facts in this Record disclose a series of fraudulent deals and practices by Standard, a public utility holding company, in its self-dictated dealings with its subsidiary, the Debtor. The legislative and executive branches of our Government have already taken steps to cure the evil practices prevalent among public utility holding companies. This Court should undertake in the instant case to place the judicial stamp of rejection on such practices.

4. Presumption of Fraud in Dealings Between Common Directorates.

The decision of the Circuit Court of Appeals is in conflict with the applicable decisions of this Court and the decided weight of authority in refusing to apply the rule of law that a presumption of fraud attaches to dealings between common directorates of affiliated companies. The entire Standard claim arises out of such dealings. Under this rule, Standard was bound to undertake the burden of overcoming the presumption of fraud and proving the fairness of its self-dictated dealings with the Debtor. Through the device of a compromise of its claim, Standard has entirely avoided that burden. Public interest requires that this Court undertake to establish that this highly important rule of law cannot be circumvented in this way.

5. Compromise Powers in 77-B Proceedings.

The Circuit Court of Appeals has erroneously decided an important question of Federal law which has not been, but should be settled by this Court, in its adjudication on the scope of a District Court's powers in 77-B proceedings to compromise claims under Section 27 of the Bankruptcy Act (11-U. S. C. A., Sec. 50). By its decision, the Circuit Court of Appeals held that the District Court had the power in 77-B proceedings to allow a claim by compromise, without regard to the best interests of a five million dollar class of public preferred shareholders which is being wiped out by the compromise. In former decisions under Section 27, the Bankrupt was always insolvent and thus, only the interests of creditors had to be taken into account. Since the enactment of 77-B, it is submitted that this Court should require that in the making of a compromise, the interests of stockholders having an equity in the Debtor's assets must also be given adequate consideration.

6. Impropriety of Majority's Refusal to Adjudicate Standard Claim.

The two majority members of the Circuit Court of Appeals expressly refused to pass upon the validity of the Standard claim. Nevertheless, they approved its compromise allowance in the amount of five million dollars, thereby wiping out the entire equity of the public preferred shareholders of the Debtor, without even an adjudication that that elimination was a meritorious one. This compromise, thus approved, gave no regard to the legal requirement for the actual existence of a valid claim. *Moreover, on the only two occasions when the question of the validity of the claim was ever passed on, separate opinions of two Federal Judges (dissenting opinion of Circuit Judge Bratton and opinion of District Judge) have held that the claim was invalid in its entirety.* Under these circumstances, the refusal by the majority of the Circuit Court of Appeals to adjudicate the validity of the Standard claim must be deemed so great a departure from the accepted and usual course of judicial proceedings as to call for the exercise of this Court's power of supervision.

7. Impropriety of Inserting Compromise In Plan of Reorganization.

The Circuit Court of Appeals has erroneously decided an important question of Federal Law affecting 77-B proceedings which has not been, but should be settled by this Court. By its decision, the Court upholds the propriety of compromising a litigated claim as part of a Plan of Reorganization, contrary to the provisions and intent of the 77-B Act.

8. Unfair Practices of Banker and Management Controlled Reorganization Committees.

This Court should undertake to establish its views on the highly important public question of the propriety of Banker

and Management controlled Reorganization Committees and their prevalent practices as developed by the Record in the instant case. In this case, the Reorganization Committee, representing a majority of the securityholders, was admittedly formed and actually controlled by the Standard interests. It undertook as its major task the allowance of the Standard claim as part of the Plan of Reorganization. In so doing, its fiduciary obligation to the public securityholders was adverse to the interests of Standard. Such conflict of interest could only result, as it did in the instant case, in flagrant abuse of its fiduciary obligations to the detriment of the public securityholders. The prevalence of such abuses in major reorganizations throughout the country calls for corrective measures by this Court, in addition to the steps recently taken by the Legislative and Executive Branches of our Government.

9. Bad Faith Offer and Acceptance of Plan.

The decision of the Circuit Court of Appeals is in conflict with the applicable decisions of this Court and the decided weight of authority in confirming a plan of reorganization offered and accepted in bad faith by a majority of securityholders. This Court has recognized in its consideration of equity receiverships the Rule that acceptances by a majority of a class of securityholders are not controlling, where, as here, the majority has selfish interests that are not common to the securityholders as a class. The importance of this Rule of law for maintaining equality and fairness in reorganization proceedings should warrant this Court in affirming the applicability of this Rule to 77-B proceedings.

10. Injustice of Decision of Circuit Court of Appeals.

A grave injustice has been done to a five million dollar class of public security-holders who have been deprived of practically their entire investment by the unwarranted

approval of the instant compromise and plan of reorganization. It is submitted that in the interests of justice, this Court should exercise its power of supervision to correct that error.

C. Relief.

WHEREFORE your petitioners respectfully pray that a writ of certiorari may be issued out of and under the seal of this Court, directed to the United States Circuit Court of Appeals for the Tenth Circuit, commanding that court to certify and send to this Court for its review and determination on a day certain to be therein designated, a full and complete transcript of the record and all proceedings of the case, and that your petitioners may have such other or further relief in the premises as to this Court may seem just and proper, and that the said decree of the said Circuit Court of Appeals in the said case, and every part thereof, may be reversed by this Honorable Court.

JASON L. HONIGMAN,
Attorney for Petitioners,
2003 Dime Savings Bank Building,
Detroit, Michigan.

Dated August 24, 1938.

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1938

No. 312

JOHN M. TAYLOR, OSCAR A. KENNEDY AND H. RUSSELL HASTINGS, AS THE INDEPENDENT COMMITTEE FOR THE PROTECTION OF THE HOLDERS OF PREFERRED STOCK OF DEEP ROCK OIL CORPORATION,

Petitioners,

vs.

STANDARD GAS AND ELECTRIC COMPANY, REORGANIZATION COMMITTEE OF DEEP ROCK OIL CORPORATION, H. N. GREIS, TRUSTEE OF DEEP ROCK OIL CORPORATION, AND DEEP ROCK OIL CORPORATION.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

I. Opinions of Court Below.

The District Court rendered no opinion in the instant case. The opinions of the Circuit Court of Appeals for the Tenth Circuit are officially reported in 96 F. (2d) 693-710 and in this Record at I-477-505.

II. Jurisdiction.

The decree of the Circuit Court of Appeals was entered on April 27, 1938 (I-505). A petition for rehearing was filed on the twenty-fifth day of May, 1938, and was denied on the sixth day of June, 1938 (I-507, 526, 527). The statutory provision which is believed to sustain the jurisdiction of this Court is Section 240(a) of the Judicial Code as Amended (28 U. S. C. A., Sec. 347).

III. Statement of the Case.

The essential facts of the instant case have been stated in the foregoing petition, reference to which is prayed.

IV. Specifications of Error.

The District Court erred in its orders of December 22, 1936, and February 3, 1937, and the Circuit Court of Appeals for the Tenth Circuit erred in affirming them, because

1. Under the substantially undisputed facts of the instant case and as a matter of law, Standard was entitled to no claim as a creditor of Deep Rock, by reason of the applicability of the Instrumentality Rule.

2. Under the uncontradicted and overwhelming weight of the evidence, a total of $20,000,000 of specific items of charges included in Standard's account against the Debtor are invalid and unsustainable. (See specific items listed in Record at I-338-345.) If only one-half of these wrongful charges are eliminated, it requires the complete disallowance of the entire Standard claim.

3. The validity of the Standard claim should have been adjudicated on its merits.

4. The compromise was contrary to the best interests of the preferred shareholders of the Debtor and was unwarranted under all of the circumstances of the instant case.

5. The instant compromise was precluded by reason of *res adjudicata* resulting from the District Court's rejection of the first compromise proposal.

6. The compromise proposal was not presented or recommended by the Trustee, nor was there any proof of fairness thereof, contrary to the provisions of Section 27 of the Bankruptcy Act and General Order in Bankruptcy No. 33 (11 U. S. C. A., Secs. 50 and 53).

7. The compromise proposal was a fraudulent device to release Standard from its burden of proving the fairness of the transactions with Deep Rock upon which the open account is based, contrary to the rule of law that attaches a presumption of fraud to dealings between common directorates.

8. The compromise was inserted as part of the Plan of Reorganization, contrary to the provisions and intent of the 77-B Act.

9. The Plan was unfair in that it unfairly allocated the major portion of the Debtor's assets to Standard at the expense of the public preferred shareholders of the Debtor.

10. The Plan was unfair in that it was wrongfully predicated on the assumption that Standard has a valid claim as a creditor of Deep Rock in the amount of five million dollars.

11. The Plan was unfair in that it was wrongfully predicated on the so-called Trustee's Appraisal of the Debtor's fixed assets, which appraisal was unfairly low, was not made by disinterested persons, and failed to take into account the earnings or earning power of the Debtor as a going-concern.

12. The compromise and Plan were offered and accepted in bad faith by Standard, the Debtor, the Respondent Re-

organization Committee, and by the largest individual holders of preferred stock.

13. The District Court and the Circuit Court of Appeals should have refused to approve and confirm the compromise and Plan and should, instead, have denied the allowance of any claim to Standard by an adjudication on the merits of the Standard claim and should have adjudicated that the Debtor was the owner of all of the assets of the Refining Company, free of any claims on the part of Standard or its nominees.

V. Summary of Argument.

For the sake of brevity, reference is prayed to the "Reasons for Granting Certiorari," contained in the foregoing petition for certiorari.

VI. Argument.

1. Application of the Instrumentality Rule in 77-B Proceedings.

The applicability of the Instrumentality Rule in the instant case is entirely a matter of law, the facts being substantially undisputed. Petitioners have claimed throughout, and were sustained by Circuit Judge Bratton (I-504) in their contentions, that the Instrumentality Rule of law should be applied in denying Standard's claim as a creditor against Deep Rock, its instrumentality subsidiary. If Standard has no valid claim, then, we submit, that the approval of the compromise allowance of that claim at five million dollars was erroneous as a matter of law. In refusing to apply the Instrumentality Rule in the instant case, the decision of the majority members of the Circuit Court of Appeals is clearly in conflict with the decisions of this Court and the decided weight of authority.

The Instrumentality Rule is a fairly recent development of the law. This Court was among the first to blaze the trail in the recognition and development of this Rule. The Rule has been stated by this Court to be a broad equitable rule of law, that separate corporate entities of a parent and subsidiary will be disregarded by the courts

> "• • • where stock ownership has been resorted to, not for the purpose of participating in the affairs of a corporation in the normal and usual manner, but for the purpose • • • of controlling a subsidiary so that it may be used as a mere agency or instrumentality of the owning company. • • • In such a case the courts will not permit themselves to be blinded or deceived by mere forms of law but, regardless of fictions, will deal with the substance of the transaction involved as if the corporate agency did not exist and as the justice of the case may require." (From the opinion of Mr. Justice Clarke in *Chicago, M. & St. P. Ry.* v. *Minn. Civic. Assn.*, 247 U. S. 490, 501, 62 L. Ed. 1229.)

This rule has often been applied by this Court in piercing the forms of separate corporate entities "as the justice of the case may require." /Under the decisions of this Court, the parent company has been held liable for the obligations of its "instrumentality" subsidiary on contracts and torts and also as the real offender in statutory violations committed through its "instrumentality" subsidiary.

McCaskill v. *U. S.*, 216 U. S. 504, 54 L. Ed. 590 (1910);

U. S. v. *Lehigh Valley R. R. Co.*, 220 U. S. 257, 55 L. Ed. 458 (1911);

U. S. v. *Del., L. & W. R. R. Co.*, 238 U. S. 516, 59 L. Ed. 1438 (1915);

Hart Steel Co. v. *Railroad Sup. Co.*, 244 U. S. 294, 61 L. Ed. 1148 (1917);

U. S. v. *Reading Co.*, 253 U. S. 26, 64 L. Ed. 760 (1920).

The Instrumentality Rule has likewise been applied to deny the parent company's claim as a creditor upon the receivership or bankruptcy of its "instrumentality" subsidary.

Centmont Corp. v. *Marsch,* 68 F. (2d) 460 (C. C. A. 1, 1933);

E. E. Gray Corp. v. *Meehan,* 54 F. (2d) 223 (C. C. A. 1, 1931);

Clere Clothing Co. v. *Union Trust & Savings Bank,* 224 Fed. 363 (C. C. A. 9, 1915);

In re Kentucky Wagon Manufacturing Co., 71 F. (2d) 802 (C. C. A. 6, 1934);

Edward Finch Co. v. *Robie,* 12 F. (2d) 360 (C. C. A. 8, 1926);

Baker Motor Vehicle Co. v. *Hunter,* 238 Fed. 894 (C. C. A. 2, 1916);

In re Burntside Lodge, Inc., 7 Fed. Supp. 785 (D. C. Minn. 1934);

Matter of Otsego Waxed Paper Co., 14 Fed. Supp. 15 (D. C. Mich. 1935);

Albert Richards Co. v. *The Mayfair,* 287 Mass. 280, 191 N. E. 430 (1934);

S. G. V. Co. of Dela. v. *S. G. V. Co. of Pa.,* 264 Pa. 265, 107 Atl. 721 (1919);

Powell, Parent and Subsidiary Corporation (1931) pp. 112-114;

Latty, Subsidiaries and Affiliated Corporations (1936) pp. 151-153.

We submit that in not one of these cases has there been nearly as many factors calling for the application of the Instrumentality Rule as appear in the instant case and as set forth in the petition herein. We have seen that Standard had complete control over the Debtor and its management; that it ran the Debtor's affairs to suit its own ends and without any regard for the interests of the Debtor or the

latter's public securityholders; that the operating officers of the Debtor were at all times completely subservient to Standard's top-officers who, at the same time, were also the top-officers of the Debtor; that through dummy officials and by direct intervention, Standard dictated, without restraint, the many fraudulent transactions which form the basis of its claim as a creditor of the Debtor; that Standard misled the Debtor's securityholders through misrepresentations and market manipulations of the Debtor's securities; that Standard exercised all the attributes of a sole owner of the Debtor's assets, yet upon bankruptcy of the Debtor, it seeks to share as a creditor rather than as an owner of those assets. We submit that within the principles laid down by this Court, the interests of justice require the denial of Standard's claim to share as a creditor of the Debtor at the expense of the public securityholders whose rights have throughout been flaunted. The majority's decision in the instant case was, we submit, merely giving lip-service to the Instrumentality Rule, when it recognized its existence while, at the same time, it refused to apply the Rule to deny Standard's claim.

The decisions that have thus far applied the Instrumentality Rule in denial of a parent company's claim as a creditor against its instrumentality subsidiary have relied upon the principles laid down by this Court. This Court, as yet, however, has never decided a case involving the application of the Instrumentality Rule to deny a parent company's claim as a creditor upon receivership or bankruptcy of its "instrumentality" subsidiary. This phase of the Instrumentality Rule is of particular public importance in view of the advent of 77-B proceedings for corporate reorganization. The reorganization of many of the largest corporations of this country involve the disposition of large claims between interrelated corporations, under circumstances necessarily involving the applicability of the Instrumentality Rule. By this Court's delineation of the applicability of the

Instrumentality Rule to such situations, a great service will have been performed for thousands of public security-holders whose rights, as in the instant case, are dependent upon the application of that Rule.

2. Unfair Appraisal in 77-B Proceedings.

As we have hereinbefore seen, a fair appraisal of the Debtor's assets would leave a substantial equity for the preferred shareholders, even assuming that Standard has a valid claim of five million dollars. The importance of a fair and disinterested appraisal has long been recognized by this Court. The appraisal accepted by the District Court, however, was neither fair nor disinterested.

It was to Standard's interest to arrive at a low valuation of the Debtor's assets in order to justify the elimination of the preferred shareholders from any equity in the Debtor's assets. It is undisputed that the instant appraisal was prepared by employes having a primary allegiance to Standard (II-526, 484). These same employes were originally hired by Standard and under the Plan of Reorganization they would again be in Standard's employ (II-519, 463). These same employes had previously submitted appraisals of the Debtor's fixed assets in an amount four times higher than now claimed when it suited Standard's needs in the manipulation of the Debtor's securities (III-113, 125, II-102, 193, 534-5). It is little wonder that they submitted the instant appraisal to again suit Standard's needs, although it was by far the lowest appraisal ever made of the Debtor's fixed assets (III-125, II-102, 193, 534-5) (I-43, II-595-605) (II-676-9) (III-130) (III-146, II-519, 512-14) (II-781-2, 537-40).

Moreover, as we have seen, the Trustee who lent his name to this appraisal had already made a substantially higher appraisal of these same fixed assets which was some seven million dollars more than his present appraisal (II-512-14,

519). This gross discrepancy, the Trustee did not even attempt to explain.

Furthermore, the instant appraisal admittedly gave no consideration to the tremendous earnings and earning power of the Debtor as a going concern (II-501, 504, 528-9, 566). No appraisal can be deemed a fair one that disregards this important factor.

This Court, through the opinion of Mr. Justice Brandeis, in the case of *National Surety Co.* v. *Coriell,* 289 U. S. 426, 77 L. Ed. 1300 (1933), reversed the confirmation of a plan of reorganization in a Federal Equity Receivership. In so doing, the opinion pointed out that "a trustworthy appraisal" by "a disinterested appraiser" was a necessary prerequisite to a fair reorganization. This Court there pointed out further that a fair appraisal must take into account "results of the operation of the business".

These requirements were further stressed by this Court in the subsequent case of *First National Bank* v. *Flershem,* 290 U. S. 504, 78 L. Ed. 465 (1934), wherein this Court, after granting certiorari, reversed the decision of the Circuit Court of Appeals entirely by reason of an inadequate appraisal of the assets. In that case, Mr. Justice Brandeis again pointed out the indispensability of an appraisal "by independent experts" and the requirement that a fair valuation of the business of a corporation must take into account its value "as an entirety as a going concern".

The requirement that the earning power of a corporation must be taken into account in any fair valuation of the assets of a going concern has been recognized on every occasion that it has come before the courts. Some of these decisions are:

Borg v. *International Silver Co.,* 11 F. (2d) 147 (C. C. A. 2, 1925);

Doyle Dry Goods Co. v. *Lewis,* 5 F. (2d) 918 (C. C. A. 8, 1925);

Allied Chem. & Dye Corp. v. *Steel & Tube Co.,* 14 Del. Ch. 64, 122 Atl. 142 (1923);

Ahlenius v. *Bunn Humphries, Inc.,* 358 Ill. 155, 192 N. E. 824 (1934).

In 77-B proceedings, the importance of a fair and disinterested appraisal can scarcely be overestimated. See *Jamieson* v. *Watters,* 91 F. (2d) 61 (C. C. A. 4, 1937). Section 77-B, unlike bankruptcy, contemplates the continuation of the Debtor as a going concern. To value the assets of the Debtor in 77-B proceedings without giving consideration to its earning power as a going concern ignores the basic nature of the 77-B Act. It is respectfully submitted that this Court, by its decision in the instant case, should propound the rule that an appraisal in 77-B proceedings must take into account the earnings of the Debtor as a going concern and must comply with the same principles of fairness which this Court has already laid down for equity receiverships.

3. Abuses of Public Utility Holding Companies.

The fraudulent charges which Standard, a billion dollar public utility holding company, foisted upon its subsidiary, the Debtor, are typical of the abuses by many public utility holding companies which have brought upon them both public and legislative condemnation. In the instant case, petitioners have urged that the Standard claim includes some twenty million dollars of fraudulent and unsustainable charges which it imposed on Deep Rock (I-335-346).

Typical among these are the charges of $1,200,000 for management fees for services which in fact were never rendered (II-4-5, 7, 9-10, 14-16, 27-29, 40, 41, 55-59, 227-8, 229). Standard imposed these latter charges through the medium of its wholly owned subsidiary, the Byllesby Engineering and Management Corporation as part of its general policy

of imposing such charges on its various public utility subsidiaries (II-3, 7-8, 100-1, 359, 691). The fraudulent nature of these charges was reluctantly conceded by the Vice-President of Byllesby and Company (II-433-4) and was further acknowledged by the Attorney for the Trustee, who stated:

> "This Management Corporation, that is the same thing Congress has had in this Holding Company Bill. * * * Just like all these other public utilities were doing, the purpose is to make a *fictitious* overhead charge on public utilities in order to maintain their rates. Now this Management Corporation, the Standard owned all of its stock, said so in its annual reports. It received from that Company over $23,000,000 in dividends, and they (Management Corporation) never had any assets except pencils and drawing tools" (II-405).

Legislative and Executive action has already been taken to curb the prevalent abuses committed by public utility holding companies. It is respectfully submitted that this Court, by its decision in this case, can aid in correcting a situation which has become a national problem.

4. Presumption of Fraud in Dealings Between Common Directorates.

All of the dealings upon which Standard's claim against Deep Rock is based are admittedly dealings between a common directorate and interlocking officers (II-324-56). This Court, as well as the decided weight of authority, has established the Rule that such transactions are presumptively fraudulent.

Corsicanna Nat. Bk. v. *Johnson*, 251 U. S. 68, 64 L. Ed. 141 (1919);

Geddes v. *Anaconda Copper Mining Co.*, 254 U. S. 590, 65 L. Ed. 425 (1921);

Western Distributing Co. v. *Public Service Commission,* 285 U. S. 119, 76 L. Ed. 655 (1932);

Hyams v. *Calumet & Hecla Mining Co.,* 221 Fed. 529 (C. C. A. 6, 1915);

International Radio & Telephone Co. v. *Atlantique Communication Co.,* 290 Fed. 698 (C. C. A. 2, 1923);

Vallery v. *Denver & R. G. R. R. Co.,* 236 Fed. 176 (C. C. A. 8, 1916);

Penn. Canal Co. v. *Brown,* 235 Fed. 669 (C. C. A. 3, 1916);

Forbush Co. v. *Bartley,* 78 F. (2d) 805 (C. C. A. 10, 1935);

Farmers Loan & Trust Co. v. *N. Y. & M. R. Co.,* 150 N. Y. 410, 44 N. E. 1043 (1906);

Allied Chemical Dye Corp. v. *Steel & Tube Co.,* 14 Dela. Ch. 1, 120 Atl. 486 (1923).

Speaking of the basis for this rule, this Court has held:

> "The relation of directors to corporations is of such a fiduciary nature that transactions between boards having common members are regarded as jealously by the law as are personal dealings between a director and his corporation; and where the fairness of such transactions is challenged, the burden is upon those who would maintain them to show their entire fairness; and where a sale is involved, the full adequacy of the consideration. Especially is this true where a common director is dominating in influence and character. This court has been consistently emphatic in the application of this rule, which, it has declared, is founded in the soundest morality, and we now add, in the soundest business policy. Twin Lick Oil Company *v.* Marbury, 91 U. S. 587, 588; 23 L. Ed. 329, 330; Thomas *v.* Brownville, Ft. K. & P. R. Co., 109 U. S. 522, 27 L. Ed. 1018, 3 Sup. Ct. Rep. 315; Wardell *v.* Union P. R. Co., 103 U. S. 651, 658, 26 L. Ed. 509, 511; Corsicanna Nat. Bank *v.* Johnson, 251 U. S. 68, 90, 64 L. Ed. 141, 155, 40 Sup.

Ct. Rep. 82. * * *" (From the opinion of Mr. Justice Clarke in *Geddes* v. *Anaconda Copper Min. Co.*, 254 U. S. 590, 599, 65 L. Ed. 425 (1921.)

In the instant case, Standard had the burden of proving the fairness of its dealings with Deep Rock as a condition precedent to the establishment of its claim. Through the device of a compromise proposal, Standard has established its claim without being required to overcome the presumption of fraud which this Rule attaches to its dealings with Deep Rock. Thus, a way has been opened to avoid the rigid judicial scrutiny of such transactions required by this long established Rule.

"Soundest morality" and "soundest business policy" require that this Court undertake by its decision in the instant case to prohibit the evasion of this salutary rule of law.

5. Compromise Powers in 77-B Proceedings.

In the instant case, the District Court invoked the powers of Section 27 of the Bankruptcy Act (11 U. S. C. A. Sec. 50) in the compromise of a claim in 77-B proceedings. By its terms, Section 27 authorizes the compromise of a claim in bankruptcy when it is "for the best interests of the estate".

In the instant case, this Act was applied in compromising the Standard claim in disregard of the "best interests" of the public preferred shareholders of the Debtor. Under the appraisal accepted by the Court there was only a five million dollar equity in the Debtor's assets for satisfaction of the claims of both Standard and the preferred shareholders. The preferred shareholders gained nothing by the compromise inasmuch as their equity was as completely eliminated by the compromise allowance of Standard's claim at five million dollars as it could be by the allowance of the Standard claim at its full amount of some nine million dollars. Standard, on the other hand gained as complete a victory

by the compromise as it could possibly gain by a victory in the trial on the merits of its claim. Thus, the compromise was clearly contrary to the "best interests" of the preferred shareholders.

Prior to the 77-B act, the only concern of the Bankruptcy courts was with the "best interests" of the creditors of the estate. The instant case, however, presents the question of whether in 77-B proceedings the compromise of a claim must also consider the "best interests" of stockholders who have an equity in the Debtor's assets. It is respectfully submitted that by its decision in the instant case, this Court should lay down the proper limitations of compromise powers in 77-B proceedings.

6. Impropriety of Majority's Refusal to Adjudicate Standard Claim.

Both Majority opinions of the Circuit Court of Appeals refused to pass on the merits of the Standard claim. Circuit Judge Phillips states in his opinion:

> "Clearly whether Standard was entitled to the allowance of its claim on the merits is not the issue here presented" (I-492).

Circuit Judge Williams likewise asserts in his opinion:

> "It is not to be understood that I express any opinion as to whether the Deep Rock Oil Corporation was an instrumentality of the Standard Gas and Electric Company" (I-499).

These holdings are in direct conflict with the basic requirement for the provability of a claim in bankruptcy. The test of provability of a claim in 77-B proceedings is stated in the opinion of Circuit Judge Chase in the recent case of *In re United Cigar Stores Co. of America*, 82 F. (2d) 247 (C. C. A. 2, 1936):

> "Section 77-B of the Act (11 U. S. C. A. Section 207 (B) permits the filing of 'claims of whatever character against the debtor or its property, including claims under executory contracts, whether or not such claims would otherwise constitute provable claims under this Act (Title).' *So here the test of provability is the actual existence of a valid claim.*" (Italics ours.)

By its refusal to adjudicate the validity of the Standard claim, the majority of the Court failed to apply the test of "actual existence of a valid claim."

The Court's refusal to adjudicate the validity of the Standard claim is, moreover, paradoxical in that, by approving the compromise, the Court indirectly does adjudicate that Standard has a valid claim of five million dollars. Such a highly incongruous result is particularly unwarranted where, as here, the validity of the claim is so seriously open to question. *On the only two occasions when the validity of the Standard claim has judicially been passed on, it has been held that the Standard claim is invalid in its entirety.* The District Judge so held in his opinion stated in open court at the time of the rejection of the First Compromise Proposal (II-406-7). Circuit Judge Bratton likewise so held in his dissenting opinion (I-505).

It is, we submit, exceedingly unfair that, without even taking issue with these holdings that the Standard claim is actually invalid in its entirety, the Majority nevertheless approve the compromise allowance of that claim at five million dollars. *By its refusal to adjudicate the merits of the Standard claim, the Circuit Court of Appeals effectively eliminated the preferred shareholders without even an adjudication that that elimination is a meritorious one.* It effectually deprived the preferred shareholders of their day in Court under circumstances that are clearly contrary to any basic notions of fair play. Under these circumstances, the refusal of the Court to adjudicate the Standard claim

on its merits is, we submit, a gross injustice calling for supervisory correction by this Court.

7. Impropriety of Inserting Compromise in Plan of Reorganization.

In the instant case, the Plan of Reorganization and the Compromise allowance of the Standard claim are made a part of each other (I-381-2, 393-5). In this way, the Standard claim is allowed for the first time in the Plan of Reorganization itself.

In order to arrive at fair and equitable plans of reorganization, it is necessary that the amount and priority of claims and securityholders should be established prior to the promulgation of a plan of reorganization. Unless that is first determined, the fairness of the participation granted to the different classes of securityholders under the plan of reorganization can scarcely be judged.

This was admitted by the attorney for the Respondent Reorganization Committee at the close of the hearing on the first compromise proposal. He told the District Judge that the adjudication of the Standard claim was

> "• • • a primary step precedent to the submission of the plan (of reorganization) to the Court • • • I cannot see the possibility of preparing a Plan of Reorganization which has as one of its (conditions) the compromise or disposition of a claim" (II-409-10).

Despite this view conceded by the attorney for the Respondent Reorganization Committee, the Amended Plan of Reorganization combined the Compromise of the Standard claim with the Plan of Reorganization.

There is no express provision in the 77-B Act which permits such a combination. As a matter of principle, the basic objection to such combination is that, where, as here, the Plan of Reorganization itself first establishes the propriety

and amount of the claimant's claim, the inquiry as to the fairness of the Plan is so highly interwoven with the inquiry as to the propriety of the claim as to befog both issues. Such a result is clearly contrary to the spirit and intent of the 77-B Act. It is the aim of 77-B proceedings to open to light all of the basic problems incident to the reorganization of a particular debtor. This Court should undertake to prohibit the use of methods which, as in the instant case, becloud the issues and result in unfair and inequitable plans of reorganization.

8. Unfair Practices of Banker and Management Controlled Reorganization Committees.

The Reorganization Committee in the instant case was admittedly organized by Byllesby & Company, the top holding company controlling Standard and the Committee thereafter constantly favored Standard as against the interests of the public preferred shareholders whom it purported to represent (II-312, 395, 423-4, 465, 717).

Gross abuses of such reorganization committees have already subjected them to remedial legislation. A comprehensive study of the activities of such reorganization committees is contained in a published report by the Securities and Exchange Commission, dated May 10, 1937, written pursuant to an Act of Congress (Section 211 of the Securities Exchange Act of 1934). This report is entitled "Report on the Study and Investigation of the Work, Activities, Personnel, and Functions of Protective and Reorganization Committees." *We submit that there is hardly a single trick that is employed by unscrupulous reorganization committees as disclosed by that report that cannot be found in the Record of the instant case.*

The record of the Reorganization Committee in the instant case well justifies the conclusions of the Securities and Exchange Commission, as expressed by its one time Chairman.

The Honorable Joseph P. Kennedy when he said (S. E. C. Report, Part II, page 509):

> "The activities of Protective Committees constitutes one of the most dismal chapters in the annals of American finance. * * * The investment banker, except in rare cases, organizes these Committees for selfish purposes, and the interests of the securityholders are a secondary consideration at best. * * *
>
> "In many instances the bankers organized a committee for the express purpose of taking command of the reorganization and, by covering up the evidence of their past wrongdoings, insulating themselves against liability. In practically every case, the bankers were motivated by a greedy desire to preserve or secure control, so that they might enjoy the perquisites thereof. This is the equivalent of what we call 'graft' in public life."

See, also, dissenting opinion of Mr. Justice Stone in *U. S.* v. *Chicago, M. St. P. & P. R. Co.*, 282 U. S. 311, 331, 75 L. Ed. 359.

In the instant case, the Record discloses that the Reorganization Committee has used many of the artifices condemned in that report in aiding Standard to accomplish its aim of wiping out the preferred shareholders of the Debtor. It is respectfully submitted that this Court by its decision in the instant case should enunciate the principles by which reorganization committees should be bound in their representation of public securityholders.

9. Bad Faith Offer and Acceptance of Plan.

The instant Record discloses that the offer and acceptance of the Plan was in bad faith. The offer of the Plan was made by Standard through its instrumentality, the Respondent Reorganization Committee (I-276, II-717). From the outset, they sought to eliminate the preferred shareholders from their equity in the Debtor's assets by the offer of the First Plan of Reorganization (II-819, 406), which was defeated by the Taylors.

The offer and acceptance of the Amended Plan was equally in bad faith. The instant Record discloses that the public preferred shareholders represented by the Reorganization Committee were misled in their acceptance of the Plan by the misrepresentations and artifices of the Reorganization Committee (II-682-4, 444, 451-2).

Moreover, the largest individual holder of preferred shares of Deep Rock, holding 6,000 shares, is Utility and Industrial Corporation, a wholly controlled subsidiary of Byllesby & Company (II-580-4, 715-16). Its acceptance of the Plan was purely at the dictation of its masters, Byllesby and Company and Standard.

The Pitcairn interests, the second largest preferred shareholder, hold 2,350 shares. Prior to the hearing on the Amended Plan, they had joined with petitioners in opposing the Plan and Compromise (I-33). A few days before the hearing, they suddenly withdrew their powers of attorney from petitioners (I-33-4) and joined with the Reorganization Committee in accepting the Plan and Compromise (II-872). At the hearing, it developed that their change of position was actuated by reason of their ownership of a large block of Deep Rock notes (I-309). Prior to the hearing, the Reorganization Committee had agreed to double the amount of cash that was to be distributed to noteholders under the Amended Plan as then promulgated (I-302-11). In return for this and other concessions to their position as noteholders, the Pitcairn interests voted their preferred stock in support of the Amended Plan (I-33-4, II-463-4).

The Reorganization Committee further represents 969 shares of Deep Rock's preferred stock owned by Standard (II-583-4). Thus, three of the largest holders of preferred stock, holding a total of 9,319 shares out of the 29,144 shares voting for acceptance, accepted the Plan by reason of special interests not common to the entire class of preferred shareholders.

The basic rights of minority securityholders to be secure against oppression by the majority is a fundamental principle of law long recognized in receivership cases.

***Lake St. El. R. Co.* v. *Ziegler*, 99 Fed. 114 (C. C. A. 7, 1900);**

***Eshleman* v. *Keenan* (Del. Ch. 1936), 187 Atl. 25;**

***Outwater* v. *Public Service Corp. of N. J.*, 103 N. J. Eq. 461, 143 Atl. 729 (1928);**

***Hamilton-Brown Shoe Co.* v. *Ben L. Berwald Shoe Co.*, 10 F. (2d) 275 (C. C. A. 5, 1926).**

In *National Surety Co.* v. *Coriell*, 289 U. S. 426, 77 L. Ed. 1300 (1933), this Court rejected a plan of reorganization upon complaint by minority securityholders. In so doing, Mr. Justice Brandeis said (437):

> "The creditors who approved of the Plan of Reorganization appeared to be actuated in their recommendations and desires by considerations not applicable to the dissenting creditors."

This rule is of particular importance in 77-B proceedings for the protection of minority securityholders where, as here, acceptances by the majority are heavily relied upon as evidence of the fairness of a proposed Plan of Reorganization.

***Downtown Investment Assn.* v. *Boston Metropolitan Building*, 81 F. (2d) 314 (C. C. A. 1, 1936);**

***In re 1775 Broadway Corp.*, 79 F. (2d) 108 (C. C. A. 2, 1935).**

We submit that the instant Record discloses a situation where the offer and acceptances of the Plan were clearly in bad faith and should not be made binding on the minority securityholders.

It is respectfully submitted that this Court, by its decision in the instant case, should uphold the rights of minority securityholders to be protected by the requirements of good faith in the majority's offer and acceptance of plans of reorganization in 77-B proceedings.

10. Injustice of Decision of Circuit Court of Appeals.

By its decision in the instant case, the Circuit Court of Appeals affirmed the elimination of a five million dollar class of public preferred shareholders. This was accomplished, we submit, through the medium of an unfair compromise and plan of reorganization.

It is true, of course, that the matter of the compromise allowance of a claim is basically a matter of sound discretion of the court. It is clear, however, that such discretion must be exercised within the limits of fairness. In *Langnes v. Green*, 282 U. S. 531, 541, 75 L. Ed. 520, 526 (1931), Mr. Justice Sutherland held:

> "The term discretion denotes the absence of a hard and fast rule. The Styria *v.* Morgan, 186 U. S. 1, 9, 46 L. Ed. 1027, 1033, 22 Sup. Ct. 731. When invoked as a guide to judicial action, it means a sound discretion, that is to say, a discretion exercised not arbitrarily or wilfully, but with regard to what is right and equitable under the circumstances and the law, and directed by the reason and conscience of the judge to a just result."

It is submitted that in no reported case has the compromise allowance of a claim been permitted under circumstances comparable to the instant case. In no case has a claim been allowed by compromise where, as here, the following circumstances were present:

(1) Full proofs in a trial on the merits of the claim had already been completed (II-241-2);

(2) The proofs on the claim were substantially undisputed, making the issue of the validity of the claim basically an issue of law;

(3) The claim is not such as appears in the usual course of business but, on the contrary, involves intercorporate dealings between a parent company and its subsidiary, with debits and credits running over a period of many years supported by nothing more than the self-serving dictations of a single management;

(4) The uncontroverted facts disclose a situation calling for the application of the Instrumentality Rule of law in denial of the parent company's right to a claim as a creditor against its "instrumentality" subsidiary.

(5) The common directorate of the parent claimant and the Debtor requires as a matter of law the application of the rule that the claim is presumptively a fraudulent one. Through the compromise, the claimant sought to avoid its burden of proving the fairness of its self-dictated dealings with Debtor.

(6) The admitted facts disclose that the claim includes huge charges arising out of a series of actually fraudulent transactions imposed on the Debtor for the benefit of the parent claimant;

(7) An opinion had already been expressed by the District Judge that the claim was invalid in its entirety by reason of the applicability of the Instrumentality Rule to the undisputed facts (II-406-7).

(8) The compromise was clearly contrary to the best interests of a five million dollar class of public preferred shareholders.

(9) No time or expense could conceivably be saved by compromising the claim as against adjudicating it on its merits. The claim had already been tried on its merits and petitioners' active objection to this compromise was known

by its proponents prior to its submission (II-449-50). Thus, it was known that the compromise could not end the litigation and that no time or expense could be saved by the compromise as against an adjudication on the merits.

(10) The compromise was made a part of an unfair plan of reorganization.

It is respectfully submitted that no conceivable scope of judicial discretion could warrant the approval of a compromise under all of these circumstances.

Moreover, the Circuit Court of Appeals, by its decision, confirmed an unfair and inequitable Plan of Reorganization. The Plan of Reorganization is basically unfair because its allotment of the Debtor's assets to Standard at the expense of the preferred shareholders is erroneously predicated on the assumption that Standard has a valid claim as a creditor in the amount of five million dollars. The Plan is further basically unfair in being predicated upon an unfairly low appraisal of the Debtor's assets. This appraisal, as we have seen, was neither disinterested nor did it take into account the earning power of the Debtor as a going concern. Such an appraisal cannot be accepted as a fair one within the principles enunciated by this Court.

Conclusion.

We submit that the decision of the Circuit Court of Appeals is erroneous as a matter of law. It is respectfully submitted that the grave injustice of this erroneous decision to a five million dollar class of public securityholders, as well as the importance of the many problems of public concern presented by this case, should warrant this Court in granting certiorari in the instant case.

Respectfully submitted,

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Attorney for Petitioners.

Dated August 24th, 1938.